P-421/M-93-126 ORDER AUTHORIZING RECOVERY OF COSTS OF IMPLEMENTING FINANCIAL ACCOUNTING STANDARD 106

BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

Don Storm	Chair
Tom Burton	Commissioner
Cynthia A. Kitlinski	Commissioner
Dee Knaak	Commissioner

In the Matter of U S WEST Communications, Inc.'s Petition to Recover the Costs of Implementing Accounting Changes Required under Financial Accounting Standard 106	ISSUE DATE: July 21, 1993 DOCKET NO. P-421/M-93-126 ORDER AUTHORIZING RECOVERY OF COSTS OF IMPLEMENTING FINANCIAL ACCOUNTING STANDARD 106

PROCEDURAL HISTORY

I. The Accounting Change at Issue

In December of 1990 the Financial Accounting Standards Board, the professional association that sets accounting standards for American finance and business, issued a new standard on the treatment of certain post-employment benefits. These benefits are known as PBOPs, for "Post-retirement Benefits Other than Pensions." The main benefit in this category is health insurance, but life insurance, dental insurance, and miscellaneous benefits are also included. The new accounting standard requires companies to account for PBOPs on an accrual basis. In the past nearly all Minnesota utilities, including U S WEST, Communications, Inc. (U S WEST), recorded these expenses on a cash basis.

Under cash basis (pay-as-you-go) accounting, PBOP expenses are not recognized on a company's books until payment is made. Under accrual accounting, these expenses are recognized on a pro-rata basis during an employee's period of service. In a recent all-utility proceeding, the Commission adopted Financial Accounting Standard 106 for recordkeeping and ratemaking purposes, subject to review of all expenses for prudence and reasonableness.[1] The Order following reconsideration in that case authorized U S WEST

[1] In the Matter of the Accounting and Ratemaking Effects of the Statement of Financial Accounting Standards No. 106, Docket No. U-999/CI-92-96, ORDER ADOPTING ACCOUNTING STANDARD AND ALLOWING DEFERRED ACCOUNTING (September 22, 1992).

to file a petition for determination of the prudence and reasonableness of its PBOP expenses apart from a general rate case or incentive plan proceeding.[2]

II. The Company's Filing; Parties' Comments

On February 17, 1993 U S WEST filed a petition seeking a Commission finding that its PBOP expenses were prudent and reasonable and Commission approval of its proposal to recover the costs of implementing FAS 106. On March 8 the Company made a supplementary filing. The Company proposed to fund both current PBOP obligations and the "transition obligation"[3] through a Voluntary Employee Beneficiary Association trust. The Company proposed to amortize the transition obligation over 17.3 years, the remaining service lives of current employees, and submitted data demonstrating the financial impact of both January 1, 1992 and January 1, 1993 implementation dates.

The following parties filed comments on the Company's proposal: the Department of Public Service (the Department), the Residential and Small Business Utilities Division of the Office of the Attorney General (RUD-OAG), the Minnesota Telephone Association (MTA), and a group of Minnesota energy utilities.[4] The MTA and the energy utilities intervened out of concern about the precedential effect of Commission action in this case.

The matter came before the Commission on June 29, 1993.

The Department and the RUD-OAG originally recommended disallowance of 50% of the transition obligation and the FAS 106 interest on grounds that the Commission had taken that action in the Minnegasco rate case, the only other Commission proceeding in which the issue of the recoverability of the transition obligation was litigated.[5] Since the reasons for disallowance

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[2] ORDER DENYING PETITION FOR RECONSIDERATION, GRANTING IN PART AND DENYING IN PART PETITIONS FOR CLARIFICATION (November 2, 1992).

[3] The transition obligation is the amount accrued for PBOP benefits from employee service already rendered, on the first day of a year in which a company moves from pay-as-you-go treatment of PBOPs to the accrual method.

[4] Those utilities were Minnesota Power, Northern States Power Company, Otter Tail Power Company, Interstate Power Company, and Minnegasco.

[5] <u>In the Matter of the Application of Minnegasco, a Division of Arkla, Inc., for Authority to Increase its Rates for Natural</u>

were policy concerns generally applicable to all utilities, these agencies urged the Commission to disallow 50% of U S WEST's transition obligation and FAS 106 interest for the same public policy reasons. The MTA and the energy utilities urged the Commission to distinguish or abandon the Minnegasco precedent. At oral argument the Department and the RUD-OAG withdrew their original recommendation on grounds that the Commission had subsequently reversed the Minnegasco decision and allowed full recovery of the transition obligation and FAS 106 interest.[6]

The remaining contested issue was the period over which the transition obligation should be amortized. The Company proposed 17.3 years, the average remaining service lives of current employees; the Department and the RUD-OAG proposed 20 years, to mitigate rate impact.

FINDINGS AND CONCLUSIONS

III. Commission Action

The issues presented by the Company's filing are as follows: (1) the prudence and reasonableness of the costs claimed; (2) the recoverability of the transition obligation and FAS 106 interest; (3) the amortization period for any portion of the transition obligation found recoverable; (4) the date on which the Company should begin implementing FAS 106; (5) the appropriateness of the funding mechanism proposed by the Company. Each issue will be addressed in turn.

A. Prudence and Reasonableness of Claimed Expenses

No party challenged the prudence or reasonableness of the Company's PBOP plan. The plan is comparable to other PBOP plans offered by similar companies. It is an employee benefit of long standing. It is one part of a comprehensive benefits package negotiated through collective bargaining. Its costs are monitored by Company management, which has instituted a managed care approach to help control costs. For all these reasons, the Commission finds the plan and associated expenses prudent and reasonable.

No party challenged the accuracy, reasonableness, or good faith of the Company's calculations of its PBOP obligations. Those

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Gas Service in Minnesota, Docket No. G-008/GR-92-400, FINDINGS OF FACT, CONCLUSIONS OF LAW, AND ORDER (May 3, 1993).

[6] ORDER AFTER RECONSIDERATION (July 19, 1993).

calculations necessarily rely in part on estimates of future health care costs. The Commission finds the Company's calculations to be reasonable, good faith estimates based on the best available information and will approve them. The Company and the Commission will continue to monitor actual expenses, to compare them with the estimates accepted today, and to make any adjustments found necessary.

B. The Recoverability of the Transition Obligation and FAS 106 Interest

As a regulatory agency, the Commission seldom makes decisions in which its own precedent plays a decisive role. First, utility issues are usually too fact-specific and interconnected for precedent to be directly applicable. Second, Commission decisions often involve careful balancing of factors affecting the public interest; minor variations in the factors and their weight can shift the balance and change the outcome. Finally, regulation is dynamic by nature -- the regulator's task is not to resolve issues once and for all but to continue addressing recurring issues in different contexts, tailoring solutions to the problems at hand and expecting policy to evolve with evolving economic, social, and environmental conditions.

In this case, however, all parties' comments focused on the precedent set by the Minnegasco rate case and the Commission's decision on reconsideration to allow full recovery of that Company's transition obligation and FAS 106 interest. In that case, too, the Commission determined that the Company's PBOP obligations were accurately calculated and stemmed from a prudent and reasonable employee benefits plan. The decision to allow full recovery was based in large part on basic regulatory principles and public policy considerations which are equally applicable here.

The Commission has re-examined the issues surrounding rate recovery of FAS 106 transition obligations and FAS 106 interest and is convinced the transition obligation and interest charges are fully recoverable for the reasons set forth in detail in the Minnegasco Orders. The Commission adopts and incorporates the rationale of those decisions and approves full recovery of U S WEST's transition obligation and interest charges.

C. The Amortization Period and Implementation Date

Under FAS 106 U S WEST can recognize the total transition obligation immediately, amortize it over the average remaining service period of active participants in the PBOP plan, or amortize it over 20 years. The Company proposed a 17.3-year amortization period, based on the remaining service period of active plan participants, for ratemaking purposes. (The Company recognized the entire transition obligation immediately for financial reporting purposes.) The Department and the RUD-OAG recommended a 20-year amortization. A shorter amortization period results in lower costs overall, but higher rate impacts in the earlier years of the amortization.

Similarly, FAS 106 would allow U S WEST to implement the accounting change on either January 1, 1992 or January 1, 1993. The earlier implementation date would save money in the long term, but would have higher rate impacts in the initial year. It would, for example, probably eliminate any 1992 refund to U S WEST ratepayers which might otherwise be payable under the sharing provisions of the Company's Incentive Plan. The Department and the RUD-OAG supported a January 1, 1993 implementation date. The Company submitted financial data showing the impact of both dates.

Determining the appropriate amortization period and implementation date are judgment calls requiring the Commission to balance ratepayers' long and short term interests and to weigh the gravity of heightening the mismatch between the time these costs were incurred and the time they will be recovered.

The Commission will adopt the 17.3-year amortization period proposed by the Company and the 1993 implementation date in the belief that these actions represent the most reasonable application of the principles of rate stability, long term financial planning, and precision in matching the time a cost is incurred with the time it is recovered. Preserving the possibility of a 1992 refund under U S WEST's Incentive Plan is consistent with public expectations and moderates the rate impact of an accounting change the ratepayers did not seek. Adopting the shorter amortization period frees the Company sooner from the financial constraints of long term amortization. It also costs the ratepayers less in the long run. Together, the two decisions strike the appropriate balance between ratepayer and shareholder, long term and short term interests.

D. The Funding Mechanism

The Company proposes to fund its accumulated, current, and future PBOP obligations through annual deposits in an externally controlled and administered trust, specifically, a Voluntary Employee Beneficiary Association Trust. No party challenged the reasonableness of this proposal, and the Department specifically supported it. The Commission agrees that the proposed trust is a reasonable and prudent means of ensuring that funds will be available to meet the Company's PBOP obligations and will approve the Company's proposal.

ORDER

1. U S WEST is granted rate recovery of its full FAS 106 transition obligation and FAS 106 interest.

2. U S WEST shall amortize its FAS 106 transition obligation over a period of 17.3 years.

3. U S WEST shall implement the accounting change required under FAS 106 as of January 1, 1993.

4. U S WEST shall use a Voluntary Employee Beneficiary Association Trust to accumulate and disburse its PBOP obligations.

5. U S WEST shall reflect the decisions made herein in its upcoming annual Incentive Plan review, Docket No. P-421/CI-89-860.

6. U S WEST shall include in any future general rate case or incentive plan filing the most recent annual update of its estimated PBOP costs and a complete description of any change(s) in its PBOP plan since its last general rate case or incentive plan filing.

7. This Order shall become effective immediately.

BY ORDER OF THE COMMISSION

Richard R. Lancaster
Executive Secretary

(S E A L)